



**TRANSFORMATIONAL LEADERSHIP AND PROFITABILITY OF SELECTED SMES IN LAGOS STATE, NIGERIA**

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**ABSTRACT**

*Small and Medium Enterprises (SMEs) are developing and pioneering businesses that have been recognized to be the economic drivers in both developed and developing nations. They are well known for their consistent contributions to a country Gross Domestic Product (GDP). Despite their economic importance, SMEs have been experiencing poor performance that hindered their growth and developments. Some of the challenges of the performance issues are improper understanding and practice of leadership. This has led to a drop in profitability which has resulted in poor performance. This study therefore investigated the effect of transformational leadership on profitability of selected Small and Medium Enterprise (SMEs) in Lagos State, Nigeria. The study adopted survey research design. The population of the study was 8,395 which is the total number of registered SMEs in Lagos State, Nigeria. A sample size of 477 supervisors and middle managers of SMEs were enumerated using Cochran;s (1977) formula. Adopted questionnaire was used and data was collected using a valid and reliable questionnaire with a Cronbach alpha value greater than 0.7. Data were analyzed using both descriptive and inferential tools. Linear Regression Analysis was used to determine the effect of the variables using Statistical Package for Social Science (SPSS) version 25. The finding revealed that transformational leadership had effect on profitability ( $\beta = 0.285$ ,  $t = 2.987$ ,  $R^2 = 0.049$ ,  $p < 0.05$ ). The study concluded that there was a statistically significant effect of transformational leadership on profitability of selected SMEs in Lagos State, Nigeria. Therefore, the study recommended transformational leadership style be used in Lagos State SMEs to attain profitability beyond expectations. This is because transactions are the foundation of transformations because when a leader honors his transactions with people, they come to trust the leader over time, and transformational leadership relies on higher levels of trust rather than compliance to achieve exemplary profitability and overall performance.*

**Keywords:** Transformational Leadership, Profitability, Small and Medium Enterprises.

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## INTRODUCTION

Small and medium-scale enterprises (SMEs) are developing and pioneering businesses that have been shown to help a country's growth and developments. They are well-known for their consistent contributions to a country's gross domestic product (GDP), creation of jobs and poverty reduction. Despite the efforts to improve the performance of SMEs in the nations where they operate, many of them continue to fall short of expectations. Their developments and growth are hampered by a variety of internal and external conditions. Some of the challenges of the performance issues are improper understanding and practice of leadership. This has led to a drop in profitability, a loss of market share, a lack of productivity, and a lack of innovation, all of which have resulted in bad performance. SMEs, which are the primary drivers of economic growth are not exempted from this because they operate in most business sectors and in the same business environment as large corporations, and their poor performance is cause for concern given their importance to global economic growth and developments.

In recent decades, experts have been interested in the role of small and medium firms in promoting global economic advancement. Small and medium enterprises are crucial in the transition to a market economy because they contribute to innovation, income generation, and economic and employment dynamism. According to statistics, SMEs account for 90 percent of firms and employ roughly 60 percent of the global workforce (Igwe, Ogunlana, Egere, & Anigbo, 2018). As a result, SMEs play a critical role in poverty reduction and long-term economic growth (World Bank, 2015; Chatterjee, Gupta, & Upadhyay, 2020; Asare, Akuffobe, Quaye, & Atta-Antwi, 2015). Despite this, SMEs are increasingly failing to succeed, with profitability declining, finance tightening, and inflationary pressures increasing (Loroun, Ming, & Ali, 2018).

SMEs in Nigeria account for 48 percent of the country's GDP, 96 percent of enterprises, and 84

percent of employment (PwC's MSMEs Survey, 2020). They are the engine of economic and social development, as well as the key drivers of growth (World Bank, 2015; Ayyagari, Demirguc-Kunt, & Maksimovic, 2014; OECD, 2017). However, SMEs in Nigeria rarely expand into huge enterprises, according to Agba, Ogaboh, and Ebong (2015), and are frequently characterized by poor performance. Their contributions to national GDP fell from 49.78 percent in 2017 to 48 percent in 2020 and their contributions to employment fell from 85 percent in 2017 to 84 percent in 2020, demonstrating the severity of their bad performance (SMEDAN, 2017; PwC's MSMEs Survey, 2020). SMEs are experiencing a significant challenge in their operational activities as a result of rapid technology progress, worldwide rivalry, and an unstable economy (Kafigi, 2015). SMEs are facing a challenging situation due to increased operational costs and diminishing profit margins (SMEDAN, 2017), which has resulted in job unhappiness and low morale among employees, resulting in decreased productivity, a lack of innovation, and a decline in profitability.

Leadership is critical to an organization's growth and performance, especially in today's competitive business world (Tewari, Gujarathi, & Madulethy, 2019; Franco & Matos, 2015). As a result, it is possible to conclude that organizational effectiveness is inextricably linked to leadership style. Leadership in SMEs is very complex and requires a leader with leadership characteristics that will help develop the business and most importantly, adopt and evolve with internal and external challenges (Seth, Rehman, & Shrivastava, 2018). The qualities attributed to leadership by Vakili, Tahmasebi, Tahmasebi and Tahmasebi (2016) include ability to innovate, plan strategically, as well as ensure business development and sustainable growth. Similarly, Arham, Boucher and Muenjohn (2013) concluded that effective leadership remains necessary to avoid organizational failures. Leadership is essential for the adequate performance of the employees in an organization. Under the support of the leaders, the employees

feel motivated to carry out the task (Kumar & Bhatti, 2020).

The evidence for a link between transformational leadership style and profitability is inconsistent and inconclusive, according to empirical study. Sofi and Devanadhen (2015) found that transformational leadership had a positive and substantial influence on profitability in their investigation of the effects of leadership styles on organizational performance in the Nigerian banking sector. Similarly, Delic, Kozarevic, and Alic (2017) conducted another study on the impact of transformational leadership style on financial performance of Bosnian banks; the findings, like the previous one, confirmed that transformational leadership style has a positive and significant impact on organizational profitability. Baekana (2017) did a similar study on banks in Ahantaman, with the conclusion that transformational leadership is the most effective way to boost profitability. Furthermore, Mekpor and Darley-Baah (2017) discovered that transformational leadership style had a positive significant link with bank profitability in their study of leadership and organizational performance in the Ghanaian banking industry.

There is a scarcity of research on transformational leadership's detrimental impact on profitability. Puni, Ofei, and Okoe (2014) conducted another study on the impact of leadership styles on organizational performance in China's banking sector; the findings found that transformational leadership styles have no meaningful impact on profitability. Therefore, the purpose of this study was to examine the effect of transformational leadership style on profitability of selected SMEs in Lagos State, Nigeria.

## LITERATURE REVIEW

### Transformational Leadership Style

Transformational leadership was initiated by James McGregor Burns in 1978. According to Burns (1978), a transformational leader can be defined as an individual that lifts the level of consciousness, in followers, about the value of specific desired results

and the approaches of reaching the specific results. Bass and Bass (2008) add to this definition by stating that transformational leaders are able to persuade followers to surpass their self-interests to instead focus on the interests of the organization, all while raising the low-level concerns of the followers to higher-level concerns such as a need for achievement and raising one's full potential. The general definition of transformational leadership suggests that transformational leaders help to transform employees from ordinary performers to extraordinary performers (Bass & Avolio, 1994; Behery, 2008; Burns, 1978). In other words, transformational leadership helps followers transform their behaviour from traditional to new way of thinking and to be innovative in the working environment. Transformational leadership is interested in motivation, goal attainment, team work and behaviours that help employees find meaning in their work and at the same time enjoy their work (Behery, 2008). According to Somboonpakom and Kantabutra, (2014) the process that involves the actions to alter the attitudes and perceptions of employees related to the organization's objectives and strategies are referred to as transformational leadership styles. Northouse (2016) defines transformational leadership as a process that changes and transforms, influencing individuals to accomplish organizational goals

Transformational leaders encourage subordinates to put in extra effort and go beyond what they (subordinates) expected before (Burns, 1978). The subordinates of transformational leaders feel trust, admiration, loyalty, and respect toward leaders and are motivated to perform extra-role behaviour (Bass, 1985; Katz & Kahn, 1978). A transformational leader is one who supports, guides, and facilitates transcendence of employees to higher level of self-actualization and thus motivates followers beyond their own self-interest in support of the organization (Yukl, 2013).

Transformational leadership style has five distinctive characteristics according to Bass and Avolio (1997); idealized attributes, idealized

influence, inspirational, individualized consideration, and intellectual stimulation (Bass & Avolio, 1997). Idealized attribute: this is defined from the point of the leader's characteristics (charismatic, confident, ethical, idealistic, and trustworthy) that is considered important. Idealized influence: this goes beyond subordinate identifying the characteristics of the leader that are deemed important to the actual behavior or actions taken by them, especially in their ability to articulate the vision of the organization clearly to the followers and motivate them to accept and internalize the vision (Bass, 1999). These characteristics of transformational leadership style make the leader charismatic and a role model to their followers (Avolio & Bass, 2004). Inspirational motivation: leaders behave in ways that motivate subordinates by providing meaning and challenge to their work. The spirit of the team is aroused while enthusiasm and optimism are displayed. The leader encourages subordinates to envision attractive future states while communicating expectations and demonstrating a commitment to goals and a share vision. Intellectual stimulation: leaders stimulate their subordinates' efforts to be innovative and creative by questioning assumptions, reframing problems, and approaching old situations in a new way. The intellectually stimulating leader encourages subordinates to try new approaches but emphasizes rationality. Individualized consideration: leaders build a considerate relationship with each individual, pay attention to each individual's need for achievement and growth by acting as a coach or mentor, developing subordinates in a supportive climate to higher levels of potential. Individual differences in terms of needs and desires are recognized (Bass, 1999).

### **Profitability**

The terms profit and profitability are used interchangeably but in the real sense and meaning there is a difference between the two. Profit is an absolute term, whereas, profitability is a relative concept (Harward, 2016). Profit is a financial gain

especially the difference between the amounts earned and amount spent in buying, operating, or producing something while; profitability is the ability of an organization to earn a return from the use of its investment (Nishanthini & Nimalathasan, 2013). It can also be the total revenue less operating expenses, interest paid, depreciation and taxes. Profitability is, therefore the capacity to make profit. Profitability is defined as the proficiency of an organization to generate earnings on sales, accomplishing desired return on investment and human resources employed in running the business operations (Adeoye & Abu, 2015). Harward (2016) viewed firm profitability as the ability of a given investment to earn a return from its use.

According to Jaggi and Considine (2017), profitability is a crucial indicator for determining the financial position of the firm. The firm is considered financially weak when its profitability is sliding or the profitability is weak compared to other firms in the industry. Profitability is one of the most important objectives of financial management because one goal of financial management is to maximize the owner's wealth (McMahon, 2015). At the establishment stage of a business it may not be profitable because of the investment and expenses for establishing the business. When the business becomes mature, profits have to be produced (Jaggi, & Considine, 2017). Thus, profitability very essential feature items in the financial report of an organization because it reveals the effectiveness and efficiency of management decisions.

Profitability means ability to make return from all business activities of an organization, firm company or an enterprise. It shows how efficiently the management can make profit using all the available resources (Barad, 2016). Profitability is important to organizations because it provides a key measure of the performance outcome of an organization that enables the management to assess their overall performance over a period of time. It can also be used as a benchmark to weigh the performance of an organization against other organizations within

an industry (Sawaeen & Ali, 2020). However, the downsides of profitability are: profitability provides information about the previous achievements but it is not an indicator for future performance. Moreover, profitability does not provide information on the relationship between business activities and financial results which has a strong influence over a business performance (Maduekwe & Kamala, 2016). In view of the above, this paper defines profitability as the ability of an entrepreneur to earn profit or excess income over amount spent in buying, operating or producing goods and services over a period of time.

### **Empirical Review**

Beakana (2017); Mekpor and Darley-Baah (2017); Tong (2020); Asrar-ul-Haq and Kuchinke (2016) Arham (2018): Delic, Kozarevic and Alic (2017) in their studies on impact transformational leadership style on profitability utilized descriptive survey research method and primary data with questionnaire as the method of their data collection. The sampling techniques used for these studies were stratified and simple random sampling while they make use of target population as their study population. For the analysis of data, descriptive and inferential statistics was utilized with linear and multiple regressions using Statistical Package for the Social Sciences (SPSS) for the analysis of the relationship between independent and dependent variables.

Mekpor and Darley-Baah (2017) in their study to examine the effect of leadership styles and on employees performance in banking sector in Ghana, the findings of the study revealed that transformational leadership style has a positive significant relationship with the bank profitability. Likewise, Tong (2020) conducted a research on the effects of transformational leadership styles and organizational performance in 350 SMEs with 421 respondents in Beijing, the results of the findings revealed that transformational leadership style is positively and significantly correlated with organizational financial performance with outcome variable of profitability. In the same vein, another

research conducted by Arham (2014) on leadership styles and performance of SMEs in Malaysia concluded that transformational leadership has a positive and significant relationship with organizational profitability. Asrar-ul-Haq and Kuchinke (2016) conducted a similar study on impact of transformational leadership on organizational performance in Pakistani banking sector and found that there is positive and significant relationship between transformational leadership and organizational performance with all the outcome variables including profitability.

Transformational leadership was found to have a strong effect on profitability in different counties as well. For instance in Bosnia, another research was carried out by Delic, Kozarevic, and Alic (2017) on the impact of transformational leadership style on financial performance in banking sector, the result of the research like the previous one confirmed a positive and significant effect of transformational leadership style on organisational profitability. The results of the findings are in corroboration with the study conducted by Baekana (2017) on banks in Ahantaman, revealing that transformational leadership has a positive and significant relationship on profitability and not only that it is the best leadership style to improve profitability. In Malaysia, the study carried out by Amirul and Daud (2012) the results of the findings revealed that transformational leadership style has a positive and significant relationship on profitability as one of the outcome variables in the study. However, Puni, Ofei and Okoe (2014) contradict these findings in their study; they found that there is no significant relationship between transformational leadership styles and profitability in their research of banks in China.

Therefore, the study hypothesizes that:

**H0<sub>1</sub>:** Transformational leadership style has no significant effect on profitability of selected SMEs in Lagos State, Nigeria

## Theoretical Review

### Path-Goal Leadership Theory (1971)

The path-goal leadership theory was propounded in 1971 by Robert House to describe the process of how leaders motivate, support and reward their followers by offering guidance to clear path through obstacles or roadblocks in order to accomplish goals. The theory believes that leaders are effective because they have an impact on the motivation, performance capabilities, and satisfaction of their subordinates. The reason as to why the theory is called path-goal is directly related to the leaders influence over subordinate's insights about their work and personal goals and their paths to attaining these goals. The behaviour of the leader is motivation or satisfaction to improve the achievement of subordinates' goals and help them to clarify the path to achieve their goals (House & Mitchell, 1975). The behaviour or situational theory "path-goal" is based on the instrumental framework that highlights how to predict the outcome of a leaders' behaviour (whether effective or not effective) and depends on the followers' capabilities (Malik, 2012). This theory is relevant to this study because a leader can motives, supports and influences the followers and helps them to clarify the path to increase their performance and to achieve the organizational goals.

According to House and Mitchell (1974), the path-goal theory has two key propositions. The first proposition of path-goal theory is that leaders' behaviour is acceptable and satisfying to subordinates to the extent that the subordinates

see such behaviour as either an immediate source of satisfaction or as instrument to future satisfaction. The second proposition of this theory is that leader's behaviour will be motivational, i.e., increase effort, to the extent that such behaviour makes satisfaction of subordinate's needs contingent on effective performance and such behaviour complements the environment of subordinates by providing the coaching, guidance and rewards necessary for effective performance.

Path-goal has two essential behavioural aspects that comprise the theory; instrumental, when the leader displays a directive approach, and supportive, when the leader shows empathy, emotion, and sensitivity towards their followers (Malik, 2012). According to House (1971), the motivational function of the leader consists of increasing payoffs to subordinates for work-goal attainment and making the path to these payoffs easier to travel by clarifying it, reducing roadblock and pit falls, and increasing the opportunities of personal satisfaction en route. House (1971) identified four leadership behaviours (directive, supportive, participative, and achievement-oriented) that, depending upon the situation, could improve the effectiveness of a leader as well as the followers' motivation, performance, and satisfaction. The directive leader advises their follower on what he or she expects of them in regards to tasks (when, what, how, and where). The supportive leader makes the work environment pleasant for their followers by showing consideration and being approachable.

### Research Conceptual Model



Figure 1: Conceptual Framework

Source: Author's Research Model (2022)

## METHODOLOGY

The study adopted survey research design. The population of the study is 8,395 which is the total number of registered SMEs in Lagos State, Nigeria. A sample size of 477 supervisors and middle managers of SMEs were enumerated using Cochran's (1977) formula. Adopted questionnaire was used and data was collected using a valid and reliable questionnaire with a Cronbach alpha value greater than 0.7. Data were analyzed using both descriptive and inferential tools. Linear and Multiple Regression Analysis was used to determine the effect of the variables using Statistical Package for Social Science (SPSS) version 25.

## DATA ANALYSIS AND RESULTS

Of the 477 copies of questionnaire distributed, 451 copies of the questionnaire were retrieved questionnaires and used for analysis which was statistically acceptable for purposes of making inference on the general population of selected SMEs in Lagos State. This represents a response rate of about 95% of the population employed in the study. The responses obtained from the data

collected from selected SMEs in Lagos State were adequate enough to fulfill the research objectives of the study.

### Restatement of Research Hypothesis

**Ho<sub>1</sub>:** Transformational leadership style has no significant effect on profitability of selected SMEs in Lagos State, Nigeria.

Simple linear regression analysis was used to test hypothesis. The independent variable was transformational leadership style while the dependent variable was profitability. In the analysis, data for transformational leadership style were created by adding together responses of all the items under the transformational leadership style to generate independent score for the construct. For profitability, responses of all items the variable were added together to create index of profitability. The index of profitability (as dependent variable) is thereafter regress on scores (index) of transformational leadership style (as independent variable). The results of the analysis and parameter estimates obtained are presented in Table 1

**Table 1: Summary of Simple Regression Analysis on the Effect of Transformational Leadership on Profitability of Selected SMEs in Lagos State, Nigeria**

Model One		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
Y=α <sub>0</sub> +β <sub>1</sub> x <sub>1</sub> + e		B	Std. Error	Beta		
1	(Constant)	2.987	.289		10.344	.000
	Transformational leadership (TL)	0.285	.060	0.220	4.785	.000

a. Dependent Variable: Profitability (PF)  
 b. R= 0.220 R<sup>2</sup>=0.049 Adj R<sup>2</sup>= 0.046  
 c. F(2, 449) = 22.892 (P<0.05)

Source: Researcher's Findings 2022

Table 1 showed the simple linear regression analysis results for the effect of transformational leadership on profitability of selected SMEs in Lagos State, Nigeria. The result revealed that transformational leadership ( $\beta = 0.285$ ,  $t = 2.987$ ,  $p < 0.05$ ) has a positive and significant effect on the profitability of selected SMEs in Lagos State, Nigeria. The R value ( $R=0.220$ ) shows that a weak but positive relationship exist between transformational

leadership and profitability of selected SMEs in Lagos Nigeria. The coefficient of determination  $R^2 = 0.049$  depicts that transformational leadership style accounts for only 4.9% variation in the profitability of the selected SMEs in Lagos State, Nigeria while the remaining 95.1% was a result of other variables not captured in the model. However, it is noted that though transformational leadership style has a significant effect on profitability, its explanatory

power is low. In an attempt to assess how the regression fits the data, the Analysis of Variance (ANOVA) was conducted. This can also be found in Table 1. The Table 1 proves that the regression model significantly fits the model well because the F statistics of 22.892 on the regression role is significant at 0.000 ( $p < 0.05$ ) signifying a significant effect of transformational leadership style on profitability. Hence, the simple regression model is expressed as:

$$PF = 2.987 + 0.285TL + e \dots \dots \dots \text{Eqn. 1}$$

Where:

PF= Profitability

TL= Transformational Leadership

The regression model above shows that when transformational leadership is held at zero, profitability of the selected SMEs would be 2.987. This implies that changes in profitability will still be noticed even without any form of transformational leadership style. Results from the Table 4.3.1c shows that transformational leadership style beta coefficient value is 0.285 which is statistically significant at 0.000 ( $p < 0.05$ ) with 't' statistics of 4.785. The results of the simple regression analysis above also reveal that when transformational leadership is increased by one unit, profitability will increase by 0.285. The findings revealed that transformational leadership has a positive and significant effect ( $\beta = 0.285$ ,  $P < 0.05$ ) on the profitability of selected SMEs in Lagos State, Nigeria. The result of the model showed a highly statistically significant result. Hence, the null hypothesis which states that transformational leadership style has no significant effect on profitability of selected SMEs in Lagos State, Nigeria was rejected.

### Discussion of Finding

The results of the combined multiple regression for Transformational leadership style had a significant effect on profitability of selected SMEs in Lagos State, Nigeria ( $\beta = 0.285$ ,  $t = 2.987$ ,  $R^2 = 0.049$ ,  $p < 0.05$ ). The findings indicated that

Transformational leadership style had a significant effect on profitability of selected SMEs in Lagos State, Nigeria. Conceptually, scholars, like (Mamman et al., 2018; Spahr 2016), viewed transactional leadership style as the one that focuses on result, conforms to the existing structure of an organization and measures success according to the organization's system of reward and punishment.

Empirically, Mekpor and Darley-Baah (2017) in their study to examine the effect of leadership styles and on employee's performance in banking sector in Ghana, the findings of the study revealed that transformational leadership style has a positive significant relationship with the bank profitability. Likewise, Tong (2020) conducted research on the effects of transformational leadership styles and organizational performance in 350 SMEs with 421 respondents in Beijing, the results of the findings revealed that transformational leadership style is positively and significantly correlated with organizational financial performance with outcome variable of profitability. In the same vein, another research conducted by Arham (2014) on leadership styles and performance of SMEs in Malaysia concluded that transformational leadership has a positive and significant relationship with organizational profitability. Asrar-ul-Haq and Kuchinke (2016) conducted a similar study on impact of transformational leadership on organizational performance in Pakistani banking sector and found that there is positive and significant relationship between transformational leadership and organizational performance with all the outcome variables including profitability.

Transformational leadership was found to have a strong effect on profitability in different counties as well. For instance, in Bosnia, another research was carried out by Delic, Kozarevic, and Alic (2017) on the impact of transformational leadership style on financial performance in banking sector, the result of the research like the previous one confirmed a positive and significant effect of transformational leadership style on organisational profitability. The

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The findings of this study are in agreement with the assumptions of the transformational theory and transactional theory whose strength are acceptable framework of how to improve an ineffective leadership style within SMEs (Sow et al, 2017) since effective leadership style is a critical factor for organizational performance. Thus, the transformational theory and transactional theory are deemed suitable in studying the effect of leadership styles on organizational performance of selected small and medium enterprises (SMEs) in Lagos State, Nigeria

Transformational leadership understands their followers' strengths and weakness, which enable the leaders to assign tasks that optimize the performance of their followers. In addition,

transformational leaders aim to motivate their followers to tailor their self-interest to align with the mission and vision of the organization (Sheshi & Karcini, 2017). The reason transformational leaders have followers is because they exhibit specific qualities that enable them to gain trust, such as honesty, loyalty, and respect. A leader who embodies their own expectations encourages change beyond just serving as a role model at the individual level.

### **CONCLUSION AND RECOMMENDATION**

Considering the empirical findings, this study concludes that there was a statistically significant effect of the transformational leadership on profitability of the selected SMEs in Lagos State, Nigeria. The findings underpin the theoretical considerations that leader can change, transform inspire the followers' needs and redirect their thinking, creativity and efforts towards increasing their performance and attainment of the organizational goals and objectives.

Based on the foregoing conclusion, the study recommends that transformational leadership style be used in Lagos State SMEs to attain profitability beyond expectations. This is because transactions are the foundation of transformations because when a leader honors his transactions with people, they come to trust the leader over time, and transformational leadership relies on higher levels of trust rather than compliance to achieve exemplary profitability and overall performance.

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